

To Federal Communication Commission  
Public Forum on the SBC/Ameritech Merger -- May 6, 1999

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**Comments of the Competition Policy Institute**

**Introduction and Summary**

Federal Communications Commission  
Office of Secretary

My name is Ron Binz and I am President of the Competition Policy Institute (CPI). CPI is a non-profit organization that advocates state and federal policies that promote competition in energy and telecommunications markets in ways that benefit consumers.<sup>1</sup> We appreciate the opportunity to present comments on this important issue.

In this testimony I would like to make three points:

- In determining whether this merger serves the public interest, the Commission must consider the purposes of Congress when enacting the Telecommunications Act of 1996. The overriding goal is to promote competition in all telecommunications markets, especially in local exchange markets that were closed to competition before the Act was passed.
- This merger proposal fails the cost/benefit test. The threat to competition posed by this merger is real and outweighs any potential benefits that might find their way to consumers of these companies.
- There are solid policy reasons why the Commission should deny this merger until the applicants make substantially more progress in opening their markets to competition.

I want to begin by stating our bottom-line advice to the Commission. We counsel the FCC against attaching conditions to this merger to be fulfilled *after* its approval. This course of action

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<sup>1</sup>CPI is advised by a committee of consumer advocates from across the country and is funded by grants from a variety of energy and telecommunications companies and associations. Complete information about CPI is available at our website, <www.cpi.org>.

is unlikely to be effective for two reasons: First, the essential problem is that the merger allows concentration to outpace the market-opening activities of these companies. You cannot fix this mismatch by allowing the merger to happen, damaging competition first, then trying to repair the harm later. The ideal Commission policy must be to synchronize the positive effect of open, competitive markets to offset the negative effects of the merger.

Second, regulation is not very good at enforcing after-the-fact conditions. There are many examples of broken promises made to state and federal regulators as trade-offs for legislative favors and regulatory relief. Once the Commission has given its approval of the merger, once the intense interest in this merger has waned, the Commission will find it very difficult and costly to track compliance with merger conditions and even harder to enforce compliance after-the-fact. The only effective remedy for non-compliance would be to unwind the merger and that is not a credible threat.

Instead, the Commission needs to have competition on its side, subjecting post-merger behavior to the pressures of the marketplace, not to a room full of regulators. For these reasons, CPI suggests that the FCC say "no" to the proposed merger unless and until SBC and Ameritech have complied fully with the requirements of the Telecommunications Act of 1996 to open their networks to competition.

To make this concept operational, we recommend that the Commission require each company to demonstrate it has implemented fully the requirements of section 251 of the Telecommunications Act, *to the same level of compliance that the Commission requires for the section 271 competitive checklist*, in enough states to comprise a majority of the access lines they serve. We are not recommending that the companies be required to gain section 271 approval, but that they fully implement section 251 to that level of compliance. Only with this *precondition*, should this merger be allowed to go forward.

### **The Commission's Use of the Public Interest Test**

In evaluating this proposed merger, the Commission must determine whether it serves the public interest. When considering prior mergers, the Commission has employed an extensive discussion of the economic benefits and disadvantages of these mergers. But the Commission should not make the mistake of limiting its public interest evaluation to a mechanical or formulaic comparison of dollar figures. In the same way, the Commission should not use its public interest authority simply to replicate the antitrust analysis performed by the Department of Justice and other antitrust authorities. The public interest standard is an inherently broader inquiry that "leaves wide discretion and calls for imaginative interpretation."<sup>2</sup>

Since passage of the Telecommunications Act of 1996, the public interest is inextricably tied to the development of competition in the telecommunications industry. The first point of analysis should be what effect this merger will have on competition; in other words, will the merger serve the purposes endorsed by Congress in the 1996 Act. While Congress did not specifically indicate that mergers such as the pending ILEC mergers were contrary to its intent, it is clear that this merger and the previous RBOC mergers upset the balance Congress fashioned in passing the Act. In particular, Congress acted under the assumption that the RBOCs would remain independent competitors of each other.<sup>3</sup>

Unfortunately, the mergers of key industry players has upset this balance to the detriment of competition and consumers. Since passage of the Telecommunications Act, the concentration of ownership in the communications industry has developed much faster than the growth of local exchange competition. If this industry consolidation continues unchecked, the pro-competitive

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<sup>2</sup> *Federal Communications Commission v. RCA Communications, Inc.*, 346 U.S. 86, 90 (1953).

<sup>3</sup> See, section 273(a) ("A Bell operating company may manufacture and provide telecommunications equipment, . . . except that neither a Bell operating company nor any of its affiliates may engage in such manufacturing in conjunction with a Bell operating company not so affiliated or any of its affiliates.")

goals that Congress endorsed in the 1996 Act may be impossible to achieve.

For this reason alone, the Commission should arrest the mergers of large incumbent local exchange carriers until these large incumbent carriers have fully opened their markets to competitors and new entrants have had an opportunity to obtain a significant presence in the marketplace. The Commission cannot “unring the bell” by undoing its prior merger approvals. It can, however, keep the balance from becoming further out of kilter by denying the pending application until such time as these large incumbent local exchange companies make significant progress in opening their networks to competitors.

### **Costs and Benefits of the Proposed Merger**

In the *Bell Atlantic Order*,<sup>4</sup> the Commission employed a balancing test to determine whether the public interest test is met with respect to each merger application. In conducting this balancing test, the Commission places the burden on the applicants to show that the merger is in the public interest. In the comments in this case, parties identified several significant potential harms from the merger. In the other direction, the purported benefits set forth by the applicants and their supporters are too speculative to deserve much credence.

The comments filed in this case identified at least four reasons why this merger will directly harm the growth of competition for local telephone service. First, the merger removes a strong and experienced potential competitor and, in some cases, an actual competitor. Second, the merger increases both the company’s ability and incentives to engage in anticompetitive activity. Third, the merger results in a loss of company that can be used to “benchmark” or compare the practices of one ILEC with another. Fourth, the merged company would have an increased ability to leverage its monopoly power over local telephone service into other related markets.

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<sup>4</sup> *In the Matter of Application of NYNEX Corp. and Bell Atlantic Corp. For Consent to Transfer Control of NYNEX Corp. and its Subsidiaries*, 12 FCC Rcd 19985, Memorandum Opinion and Order (1997).

Furthermore, the alleged benefits of the large ILEC mergers in terms of cost savings are speculative, and in any case, may not be reflected in lower rates to consumers. If the merger results in any cost efficiencies, it is unlikely that these efficiencies will be passed on to consumers. We also think the applicant's proposed "national-local" strategy is highly suspect and is, in any event, not dependent on the companies merging.

### **The Correct Policy Prescription**

Many of the problems associated with the merger could be significantly ameliorated if the applicants complied with the act's requirements to open their networks to competition.

Although the applicants maintain that they face significant competition in their home markets, it is impossible to predict today that sufficient competition will develop in the near future to counterbalance the influence the merged companies will have over telecommunications markets. To date, competition for local telephone services has not yet developed anywhere near the levels that can serve as a competitive restraint on the dominance of the incumbent local exchange carriers. The competitive local exchange carriers (CLECs) have captured only about 5% of the local telephone revenues and between 2% and 3% of the nation's access lines.

The applicants have not come close to opening their markets to competition. After three years, neither SBC nor Ameritech has complied with the requirements of the 1996 Act in a single state. If the applicants had complied with these requirements, then the Commission could have some reason to predict that competitive forces would develop in sufficient strength to ameliorate many of the potential risks to competition posed by this merger. Because of the applicants' inability, for whatever reason, to comply with the requirements set forth by Congress, the FCC and the courts to open their local networks to competitors, these companies continue to hold a near-monopoly over local telephone service. The FCC cannot be certain at this time that local telephone competition will grow to sufficient levels to create a competitive check on the practices of these companies.

For these reasons, CPI suggests that the FCC say “absolutely no” to the proposed merger unless and until SBC and Ameritech have complied fully with the requirements of the Telecommunications Act of 1996 to open their networks to competition. Over three years ago, Congress directed all large incumbent local exchange carriers to provide interconnection on a nondiscriminatory basis to other competing LECs. Neither SBC nor Ameritech has successfully complied with these requirements in a single state.

To conclude, there are two policy reasons why the FCC should link the proposed merger with companies’ compliance with these market-opening requirements. First, as discussed above, the proposed merger diminishes the prospects for vibrant local telephone competition. The merger will strengthen companies with significant market power over local exchange service, enhancing their ability to compete unfairly against new entrants in the local telephone market. Requiring the companies to open their networks before allowing them to merge will make it less likely that the merged company could engage in discriminatory and anticompetitive behavior against new entrants. These market-opening requirements are essential to the prospects that new entrants will become viable local competitors. Once these companies become a fixture in the competitive landscape, their presence in the marketplace will go a long way towards mitigating the potential economic and political power of a merged company.

Second, denial of the proposed merger will give the companies a greater *incentive* to open their markets to competition. The theory of the 1996 Act was that interLATA relief would be the “carrot” that would induce the RBOCs to open their markets to competition. After three years in which the RBOCs have made little progress toward this goal, it now appears that the prospect of long distance entry may not be a strong enough motive for the RBOCs to open their markets. If withholding long distance entry is not enough to induce them to open their networks, perhaps withholding approval of their merger will be.

Several parties allege that the applicants are deliberately slow-rolling the process of opening their markets to competition. In denying this application, the Commission does not have to decide

whether or not SBC and Ameritech are acting in bad faith; the Commission need only focus on the actual experience of competitors in the marketplace and decide how the merger will affect this process of opening markets fully to competition. Not a single ILEC has implemented a non-discriminatory operations support system or otherwise demonstrated that its network is open to competitors.

CPI understands that opening the local network to competitors is simply not easy and demonstrably takes a lot of time. But the complexity of this task is exactly why the FCC should keep the pressure on the ILECs to comply with the Act's requirements. Policy makers can be certain that the ILECs will reduce their level of commitment to this task as soon as they receive the regulatory relief that they are seeking. We are also convinced that the merger will increase the incentives and abilities of the merged companies to resist the process of opening markets.

Finally, we would counsel the FCC against attaching conditions to this merger that would be fulfilled *after* its approval. This course is unlikely to be effective for two reasons: First, the main problem is that the merger is running ahead of market-opening activities. The Commission's policy must essentially synchronize the positive effect of the market-opening activities with the negative effects of the merger. Second, regulation is not very good at enforcing after-the-fact conditions. Once the Commission has given its approval, the Commission will not be able to unwind the merger, the only way to address the harm we predict the merger will cause in the absence of local competitors.

Thank you for the opportunity to present these comments.